

Response to NCUA's ANPR Regarding Corporate Credit Unions (Responses are in Bold Type below each item)

A. Role of Corporates in the Credit Union System

With this ANPR, NCUA is considering many comprehensive changes to the corporate credit union system. Specific areas where NCUA is soliciting comment include the following:

1. Payment Systems

- a. Should payment system services be isolated from other corporate services to separate risk? If so, what is the best structure for doing so?

No. Although liquidity should be considered the core service of corporate credit unions (CCU) for natural person credit unions (NPCU), the realities of today's marketplace show clearly that liquidity should not be considered the only valuable service provided by corporates. It would be short-sighted to attempt to continue with the core service by restricting the ability of corporates to offer other valuable and needed services. For example, it is not the payment system services that caused the current problems surrounding the asset-backed securities owned by corporates (and the broader banking sector). It is, in fact, the addition of more valuable services over the years that have made the corporates more relevant and competitive in a dynamic financial marketplace. Thus, we strongly urge the NCUA to help preserve the ability of corporates to safely offer multiple services.

- b. Would it be better to establish a charter for corporate credit unions whereby a corporate's authority is strictly limited to operating a payment system?

No. See #1.a above. There are other payment systems options available, but many of these are more expensive and burdensome for NPCUs. Also, it is generally understood that most CCUs are providing payment systems at break-even, or even a loss, as a means of convenience to attract investment and settlement dollars.

- c. Should legal and operational firewalls be established between payment system services and other services?

No.

2. Liquidity and Liquidity Management

- a. Should liquidity be considered a core service of the corporate system? If so, what steps should be taken to preserve a corporate's ability to offer that service?

Yes. See above under Payment Systems. Corporates were originally formed to provide liquidity services. Other services came along later, as it was found that they could provide some of these better and at less expense than NPCUs were getting from other parties. CCUs have done a fairly good job of meeting the liquidity needs of NPCUs. Now, we find ourselves at a point of the CCUs not having sufficient sources for their own liquidity needs. This calls for the CLF to be made available directly to the CCUs as a means of further supporting their service to the NPCUs.

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- b. Should NCUA add aggregate cash flow duration limitations to Part 704? If so, how should it be structured and how would such limitations benefit liquidity management?

Perhaps there would be benefits to adding cash flow duration limits, but this would need to be thoroughly studied by individuals with significant experience in this area. However, more rules and restrictions can cause additional problems and unfortunate circumstances during periods of a significantly weak economy such as today. These restrictions should allow for proper risk taking.

- c. What cash flow duration limits would be appropriate for corporate credit unions?

See 2.b above.

3. Field of Membership Issues

- a. Should the ability of corporates to accept members from a national field of membership be eliminated?

No. The ANPR suggests a premise that the current economic crisis facing corporates is, in part, a result of the NCUA's long-standing policy of allowing corporates to have national fields. There is no credible third party evidence of which we are aware that supports the notion that having national fields has caused corporates to engage in significant undue risk. National fields have fostered healthy competition, just as it has in the broader business world—this is free enterprise and the capitalistic system that has made the U.S. the strongest financial player in the world. Fewer CCUs might very well "be in the cards," but we contend that this will probably happen regardless of the current crisis, just as it will happen with NPCUs, and for similar reasons. We should not be restricting competition and the choices for credit unions.

- b. Should corporates be required to return to defined fields of membership, i.e. state or regional FOMs?

No. But, an alternate to this would be to require each NPCU to put capital into any CCU whose services it will use, especially investment services. This might cause NPCUs to choose more closely in which CCUs they want membership. This approach might even speed up the merger of some CCUs that cannot effectively compete.

4. Expanded Investment Authority

- a. Should the expanded investment authority option for corporate credit unions continue?

Yes. This is really very simple. This may not even be the right question. The CCUs must be able to generate a greater return on certain assets than NPCUs, or they will not be able to serve our needs or build capital for their own safety and soundness. Rather, the real question should be under what conditions should the authority be granted to each CCU and what controlling procedures should be put in place.

It is important to note that expanded authority has allowed CCUs to help meet the needs of NPCUs. This is probably not the time to remove or limit this for CCUs that can demonstrate their ability to effectively manage this authority.

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- b. If so, should NCUA modify the procedures and qualifications, i.e. higher capital standards, by which corporates currently qualify for expanded authorities? What would such standards be?

Perhaps the NCUA should review current qualification standards and make changes where reasonable. For example, it might be appropriate to raise capital standards within a risk-based structure. The details of what these standards might be will require much consideration.

- c. Should the amount of expanded authorities available be reduced?

No. In fact, CCUs might need additional authorities to make investments that help offset some of the risk taken on by NPCUs. For example, NPCU's balance sheets now carry a major portion of assets in mortgage loans and mortgage-backed securities. CCUs have increased their share of mortgage-backed securities over the years. Thus, CCUs should be permitted to invest in things that counter the overweighting of mortgage-related assets on the books of both the CCUs and NPCUs.

- d. Should corporates be required to requalify for expanded authorities?

In light of recent events, it would probably be a sound practice to require CCUs to demonstrate their ongoing ability to manage the expanded investment authority they have been granted. For example, the authority could be granted for a limited number of years such as 3 to 5, with renewal required at each interval, to ensure that the corporates have appropriate management structures and sophistication in place.

5. Structure: 2-Tiered System--Retail and Wholesale

- a. Does the current two-tiered system meet the needs of credit unions?

Perhaps not two-tiered, but the corporate system itself has and should continue to help meet the needs of NPCUs. There has been talk for many years about whether there was a need for U.S. Central to remain the single wholesale corporate, as opposed to simply becoming another retail corporate, presumably with some or many smaller ones merging into it and thereby also reducing the number of CCUs. Therefore, the timing might be right for this to begin to happen. Fewer larger "retail" corporates (or perhaps we then call all of them "wholesale") could probably provide the services needed by NPCUs without having the backstop of a U.S. Central as is the current structure. The majority of NPCUs have come to rely heavily on corporates, and in some cases exclusively. Therefore, whatever changes are made, the retail corporates need to be able to continue meeting the needs of NPCUs. Also, it is critical that the process fosters competition and cooperation within the remaining corporate system in a manner to ensure that sufficient resources are there to maintain a thriving natural credit union system.

- b. Is a wholesale corporate credit union necessary? If so, what should its primary role be?

Possibly not. However, this decision should be made by the CCUs and not by the regulator (i.e., it should be done by the private sector). The NCUA should not drive the process.

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- c. Should there be a differentiation in powers between retail and wholesale corporates?

Yes, if the two-tiered system is preserved. Otherwise, what is the point of having two tiers?

- d. Should the capital requirements be the same between wholesale and retail corporate credit unions?

If the two-tiered system is preserved, capital requirements overall should be increased as stated earlier and should be risk-based. This could mean differences between the wholesale and retail corporates.

B. Corporate Capital

1. Core Capital

- a. Should NCUA establish a new capital ratio that corporates must meet consisting of only core capital and if so, at what level?

Yes. Capital modernization for both CCUs and NPCUs is long overdue. This warrants serious study that is beyond the scope of this ANPR. For example, efforts should continue in developing a risk-based capital system to bring standards more in line with other federally-insured institutions. However, the current crisis also tells us that these standards should require more capital than is currently the case for other institutions. Also, this system should be able to clearly identify those CCUs with higher levels of risk and, in turn, allow the NCUA to more effectively allocate resources to address these CCUs.

The goal should be to provide more protection to the applicable credit unions and to the system as a whole. Then, the next time a similar crisis hits (and we must plan for a next time), the system should be in better condition to handle it. Our goal should be to make credit unions (especially corporates) even better able to be competitive in the broader marketplace. This is not to say that the risk-based capital standards for CCUs should mirror those of banks, but instead should be designed specifically to meet the needs of the credit union system. Further, to help meet these new standards, CCUs might need the authority to raise capital in ways that are not currently permitted, even including some ownership interest other than by NPCUs.

- b. What is an appropriate measure of core capital?

Not sure of the exact percentage if this is what is being asked. But, the current percentage should be higher, especially for CCUs with expanded authority. The goal should also be to structure capital in a way so that the result is a greater amount of GAAP capital as well. This will require significant considerations, including what other forms of capital might be available with any changes that are made.

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- c. What degree of emphasis should be placed on generating core capital through undivided earnings?

We assume by "core" that the NCUA means "total regulatory capital." CCUs' ability to raise capital through earnings is limited, and especially so if we do anything to seriously hamper their ability to make earnings (e.g., restricting investment choices). Therefore, we might have to look more to other methods and sources. Perhaps the NCUA should require that each corporate have the same requirement on the amount of Member Capital Shares and permit corporates to provide services only to credit unions that purchase a full membership interest. And perhaps CCUs should be able to raise limited amounts of capital from parties other than credit unions.

- d. Should a corporate be limited to offering its services only to members maintaining contributed core capital with the corporate?

Perhaps yes. See preceding bullet point.

2. Membership Capital

- a. Should membership capital be permitted in its current configuration? Should it be modified?

See Core Capital section above.

- b. Should NCUA eliminate or modify certain features such as the adjustment feature, so that membership capital meets the traditionally accepted definition of tier two capital?

Possibly apply the same capital requirement consistently to all CCUs. This could be considered the cost for access to the CCU system.

- c. Should adjusted balance requirements be tied only to assets as currently provided? Should limits be imposed on the frequency of adjustments?

Yes. A minimum amount of capital should be based on asset size, but a second level of capital should be required based on the amount of services received by the NPCU. The capital should be adjusted four times per year.

- d. Should NCUA require that any attempted reduction in membership capital based on downward adjustment automatically result in the account as being placed on notice, so that a delayed payout after the three-year notice expires is permissible?

Not sure, but perhaps the 3-year period should be extended to discourage a credit union from withdrawing.

- e. NCUA also seeks comment on whether to require that any withdrawal of membership capital be conditioned on the corporate's ability to meet all applicable capital requirements following withdrawal.

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Yes. NPCUs should understand that when they become owners in a CCU, this means they could lose their investment. We believe that some credit union executives and volunteers are just now understanding this possibility.

- f. Comment is also requested on whether NCUA should consider revisions to the definition and operation of membership capital.

Yes. Perhaps the membership capital requirements should be the same for membership in any CCU, as stated above.

3. Risk-Based Capital and Contributed Capital Requirements

- g. Should NCUA consider risk-based capital for corporates consistent with that currently required of other federally regulated financial institutions? If so, what statutory or regulatory changes would be required to do so?

Yes, but also for NPCUs. However, the capital requirements should be placed high enough to provide sufficient protection for the system and other business authorities must be made consistent. The requirements for credit unions should not put them at a competitive disadvantage with banks.

- h. Should a natural person credit union be required to maintain a contributed capital account with its corporate as a pre-requisite to obtaining services from the corporate?

Yes. See earlier comments.

- i. Should contributed capital be calculated as a function of share balances maintained with the corporate? Should asset size be used in this calculation?

There should be a minimum capital requirement for each NPCU based on some measure that is consistently applied by all CCUs—perhaps asset size. Then, this requirement could fluctuate based on the share balances maintained and/or loans obtained and/or other services received (i.e., each NPCU pays a base amount of capital plus additional capital based on the total services it receives).

C. Permissible Investments

NCUA is considering whether corporate investment authorities should be constrained or restricted. To that end, they seek comment on the following:

1. Should corporate investments be limited to those allowed for natural person credit unions?

Absolutely not. To do so would effectively eliminate the ability of CCUs to provide services at reasonable prices, thereby making them non-competitive and forcing NPCUs to look elsewhere. This might call into question the need for and/or viability of the CCUs. Therefore, it is critical that the NCUA not overreact by prescribing a "one size fits all" approach. CCUs were not alone in buying some investments that were highly rated when purchased, but which could not withstand the current global mortgage and economic meltdown.

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2. Should specific categories of investment be prohibited such as collateralized debt obligations, net interest margins and subprime and ALT-A asset backed securities?

Although certain investment types may need to be reviewed from a safety and soundness perspective, it is not in the long term best interest of the credit union system, any more so than for the broader banking system, for corporate investment authority to be unduly restricted. A more measured approach would be for the NCUA to carefully review the investment management capabilities and sophistication levels of individual CCUs. It might also be appropriate to tighten at least the amount of permissible subprime and ALT-A securities that corporates can hold, as a way of limiting their exposure.

3. Should NCUA modify existing permissibility or prohibitions for investments?

See preceding two bullet points.

D. Credit Risk Management

1. NCUA is seeking comment on whether it should require more than one rating or establish that the lowest rating meet the minimum rating requirements of Part 704.

First, we must recognize that the necessity of nationally recognized and uniform standards to measure the quality of investments still exists. Therefore, until an acceptable alternative is identified, continued reliance should be placed on the ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs). As to whether the NCUA should require more than one rating or establish that the lowest rating to meet the minimum rating requirements of Part 704, one should first ask whether this would have made a difference if it had been required in the past. This question should be studied and answered before the NCUA makes a decision.

2. Should additional stress modeling tools be required in regulation to enhance credit risk management?

This is debatable at best. Again, would it have made a difference? The NCUA should test for an answer to this question before moving forward and should also weigh the costs and benefits of additional stress modeling. If the NCUA does determine that additional stress modeling should be required, then the requirements should be flexible and reasonable in relationship to the costs and benefits.

3. Should Part 704 be revised to lessen reliance on National Recognized Statistical Rating Organizations?

No. But, NRSROs should be more closely regulated. For example, these agencies have better internal governance, more regulatory oversight from the outside, and more accountability to users and regulatory agencies.

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4. Please identify any other changes that may be prudent to help assure adequate management of credit risk.

The NCUA should be careful not to overly restrict authorities, thereby damaging the entire credit union system.

5. Should Part 704 be revised to provide specific concentration limits, including sector and obligor limits? If so, what specific limits would be appropriate?

Not based on other changes likely to be made.

6. Should corporates be required to obtain independent evaluations of credit risk in their investment portfolios? If so, what would appropriate standards be?

Like stress modeling, independent evaluations can be an effective risk mitigation and management tool. However, these can be costly and may not be warranted for every investment. Therefore, there should be guidance on when and how to use these evaluations.

7. Should corporates be required to test sensitivities to credit spread widening, and if so, what standards should apply to that effort?

Yes. CCUs should monitor the credit spread changes from period to period to assess what impact it might have on their portfolio risks. The standards for this analysis, and the resulting impact, will require study beyond this ANPR.

E. Asset Liability Management

1. NCUA is considering re-instating the requirement that corporates perform net interest income modeling and stress testing.

Nil modeling might be a valuable tool, but we are not sure if this would have caused the CCUs to make different decisions as to their investments. Perhaps they might not have purchased some of the securities backed by subprime and ALT-A mortgages. And, even so, what else would they have purchased that would have given them a reasonable yield?

2. In addition, NCUA is considering some form of mandatory modeling and testing of credit spread increases.

Same as #1 above, and see #6 under Credit Risk Management above.

3. The agency is seeking comment on whether NCUA should require corporates to use monitoring tools to identify these trends, including any tangible benefits that would flow from these type modeling requirements.

Yes, if it requires the above modeling and testing.

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F. Corporate Governance

1. NCUA is considering minimum standards for directors that would require a director to possess an appropriate level of experience and independence.

The NCUA should not attempt to specify in too much detail who can and cannot serve as a director. Instead, it should require that qualified individuals be appointed to the boards of CCUs. For example, most corporates tend to have only NPCU CEOs serve on their boards and some might even permit board members of NPCUs to serve. Many times, the purpose of this approach is more political than it is for obtaining the best qualified people for the board. If we are trying to have board members who understand, to some degree at least, the investments that CCUs purchase and the board consists of only CEOs, perhaps most of whom have no investment experience, then one might question the quality of the board. Therefore, the standards should concentrate on picking qualified and experienced board members regardless of their position at the NPCUs. Additionally, selecting directors based on geography or asset size of their institution makes little sense. We need to select the most qualified volunteers.

2. Should term limits be imposed?

Yes. In conjunction with changes to minimum standards, term limits can foster innovation, creativity and enhanced oversight. Three-year terms are probably the most appropriate, perhaps with a term limit of three consecutive three-year terms for a total of nine years.

3. Should directors be allowed to receive compensation?

If outside directors are required, then compensation would most likely be required. However, this decision should be left to each CCU to make, along with the level of compensation. And, if done, then it should apply to all directors and not just the outside directors. Of course, this will make the directorship more appealing to some people within the credit union system. Therefore, the NCUA should require a serious vetting of candidates based on the newly adopted qualification standards. We note that having paid directors does not ensure a board will make quality decisions.

4. Should there be greater transparency for executive compensation?

This would not add any value to issues associated with corporate restructuring.

5. Is the current structure of retail and wholesale corporate credit union boards appropriate given the corporate business model?

No. See #8 below.

6. Should NCUA establish more stringent minimum qualifications and training requirements for individuals serving as corporate credit union directors? If so, what should the minimum qualifications be?

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Yes (and this could also apply to NPCUs). A training standard should be established that applies to each CCU. This training would include such things as the CCU's history, reason for existence, asset/liability management functions and procedures, and the investment function and processes. Directors need to have more than a basic understanding of these functions and processes at the CCU. Some CCUs already provide a limited amount of education to their directors.

7. Should NCUA establish a category of "outside director", i.e. outside the credit union industry, not an officer of that corporate, not an officer of a natural person credit union. If such an approach is recommended, should NCUA establish a minimum number of "outside directors" for a corporate?

This should be thoroughly investigated, but the final decision should be left to the CCU to make. There can be some benefit in having a limited number of outside directors. However, these people should be specifically selected for their experience. For example, a CCU's most complex assets are its investments. Thus, the outside director might be someone with extensive experience in this area.

8. Should a wholesale corporate be required to have some directors from natural person credit unions?

Yes, a minimum level should be required if the wholesale/retail levels survive this process. NPCUs are the end users of the services provided by U.S. Central and, therefore, should have some direct seats at the table. Trade groups should not have seats on the board. Any representation of NPCUs by asset category should be eliminated. The goal should be to have the best qualified individuals on the board. Perhaps a vetting by an independent third party should be part of the process.

9. Should compensation be limited to "outside directors" only?

No. See #3 above.

10. Should members of corporate credit unions be allowed greater access to salary and benefit information for senior management?

Should not be required of the CCU. The board of each corporate should be able to make that decision. NPCUs don't do business with CCUs based on what CCU staff earn or don't earn.